

Internal Revenue Service, Treasury

§ 1.996-2

Thus, \$10 is treated as distributed out of accumulated DISC income and is includible in gross income. The other \$10 is treated as made out of previously taxed income and is thus excluded from gross income. As of the beginning of 1977, Y has \$280 of accumulated earnings and profits, which consists of \$60 of accumulated DISC income, \$30 of previously taxed income, and \$190 of other earnings and profits.

[T.D. 7324, 39 FR 35120, Sept. 30, 1974, as amended by T.D. 7854, 47 FR 51742, Nov. 17, 1982]

§ 1.996-2 Ordering rules for losses.

(a) *In general.* Under section 996(b), if for any taxable year a DISC, or a former DISC, incurs a deficit in earnings and profits, such deficit shall be charged—

(1) First, to other earnings and profits (as defined in § 1.996-3(d)) to the extent thereof,

(2) Second, to accumulated DISC income (as defined in § 1.996-3(b)) to the extent thereof, subject to the special rule in paragraph (b) of this section,

(3) Third, to previously taxed income (as defined in § 1.996-3(c)) to the extent thereof, and

(4) To the extent that the amount of such deficit exceeds the sum of the amounts charged in accordance with subparagraphs (1), (2), and (3) of this paragraph, to other earnings and profits (as defined in § 1.996-3(d)).

Thus, the excess deficit charged to other earnings and profits under subparagraph (4) of this paragraph will create a deficit therein in the amount of such excess. To determine the amount of any division of earnings and profits for the purpose of determining under § 1.996-1 the treatment of any actual and certain deemed distributions, the portion of a deficit in earnings and profits chargeable under this paragraph to such division prior to such distribution shall be determined in a manner consistent with the rules in § 1.316-2(b) for determining the amount of earnings and profits available on the date of any distribution.

(b) *Deficits subsequent to a disqualification.* A deficit in earnings and profits of a DISC, or former DISC, shall not be charged to accumulated DISC income which has been determined is to be deemed distributed to the shareholders pursuant to § 1.995-3 as a result of a rev-

ocation of election or other disqualification. Thus, in accordance with paragraph (a) of this section as modified by this paragraph, a deficit incurred by a former DISC following such a revocation or disqualification shall be charged first to other earnings and profits and then to previously taxed income with any balance being charged to other earnings and profits and creating a deficit therein. The preceding sentence shall also apply in the case of a deficit incurred by a DISC which has no accumulated DISC income accumulated during its current taxable year and all immediately preceding consecutive taxable years for which it was a DISC. If as a result of the application of this paragraph the amount of a deficit in other earnings and profits exceeds the amount of a deficit in accumulated earnings and profits, then upon any subsequent actual distribution the deficit in other earnings and profits shall be reduced by the lower of (1) the amount of such actual distribution chargeable to accumulated DISC income or previously taxed income or (2) the amount of such excess.

(c) *Examples.* The provisions of this section may be illustrated by the following examples:

Example 1. X Corporation, which uses the calendar year as its taxable year, becomes a DISC beginning with 1976. In addition to other facts assumed in the table below, X incurs a deficit in earnings and profits for 1979 of \$70. Such deficit is charged to the divisions of X's earnings and profits pursuant to paragraph (a) of this section in the manner set forth in such table.

	Accumulated DISC income	Previously taxed income	Other earnings and profits
Balance January 1, 1976	\$50
Increase for 1976	\$10	\$8	
Increase for 1977	10	8	
Increase for 1978	10	8	
Balance January 1, 1979	30	24	50
Deficit for 1979 of \$70:			
Charge No. 1			(50)
Charge No. 2	(20)		
Balance January 1, 1980 ..	10	0

Example 2. Assume the same facts as in example 1, except that effective for taxable years beginning with 1979, X revokes its election to be treated as a DISC. Under § 1.995-3,

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X has \$30 of accumulated DISC income which is to be deemed distributed \$10 per year in 1980, 1981, and 1982. The deficit in earnings and profits for 1979 is charged to the divisions of X's earnings and profits pursuant to paragraph (b) of this section in the manner set forth in the table below:

	Accumulated DISC income	Previously taxed income	Other earnings and profits
Balance January 1, 1979	\$30	\$24	\$50
Deficit for 1979 of \$70:.....			
Charge No. 1			(50)
Charge No. 2		(20)	
Balance January 1, 1980 ..	30	4	0

Example 3. Assume the same facts as in example 2, except that the deficit in earnings and profits for 1979 is \$120. Assume further that for 1980, 1981, and 1982, during which years X's shareholders are receiving scheduled installments of the deemed distributions of accumulated DISC income under § 1.995-3, X, a former DISC, has neither earnings and profits nor a deficit in earnings and profits. The \$120 deficit for 1979 is charged to the divisions of X's earnings and profits pursuant to paragraph (b) of this section in the manner set forth in the table below:

	Accumulated DISC income	Previously taxed income	Other earnings and profits	Accumulated earnings and profits
Balance January 1, 1979 ..	\$30	\$24	\$50	\$104
Deficit for 1979 of \$120				(120)
Charge No. 1			(50)	
Charge No. 2		(24)		
Charge No. 3			(46)	
Balance January 1, 1980	30	0	(46)	(16)
Deemed distributions in 1980 under § 1.995-3	(10)	10		
Balance January 1, 1981	20	10	(46)	(16)

Example 4. Assume the same facts as in example 3, except that on December 31, 1980, X makes an actual distribution of \$10 out of previously taxed income. On January 1, 1981, X has \$20 of accumulated DISC income, no previously taxed income, and a deficit of \$36 in other earnings and profits. The deficit of \$16 in accumulated earnings and profits remains the same.

[T.D. 7324, 39 FR 35120, Sept. 30, 1974]

§ 1.996-3 Divisions of earnings and profits.

(a) *In general.* For purposes of sections 991 through 997, the earnings and profits of a DISC, or former DISC, shall be treated as composed of the following three divisions:

(1) Accumulated DISC income (as defined in paragraph (b) of this section),

(2) Previously taxed income (as defined in paragraph (c) of this section), and

(3) Other earnings and profits (as defined in paragraph (d) of this section).

(b) *Accumulated DISC income defined.*

(1) Accumulated DISC income is that portion of a corporation's earnings and profits which were derived during taxable years for which it qualified as a DISC and which were deferred from taxation. Accumulated DISC income as of the close of each taxable year of the corporation is—

(i) The amount of accumulated DISC income as of the close of the immediately preceding taxable year increased by,

(ii) The amount of DISC income for the year (as determined in subparagraph (2) of this paragraph) and reduced (but not below zero) by,

(iii) The items enumerated in subparagraph (3) of this paragraph.

(2) Under section 996(f)(1), DISC income is (i) the earnings and profits derived by the corporation during a taxable year for which such corporation is a DISC minus (ii) amounts deemed distributed under § 1.995-2 other than the amount of foreign investment attributable to producer's loans described in § 1.995-2(a)(5). For example, the earnings and profits of a DISC for a taxable year include any amounts includible in such DISC's gross income pursuant to section 951(a) (relating to controlled foreign corporations). Deemed distributions under § 1.995-2(a)(5) are taken into account under subparagraph (3) of this paragraph as a reduction in computing accumulated DISC income.

(3) The accumulated DISC income (as increased by DISC income for the year determined under subparagraph (2) of this paragraph) is reduced by each of the following items in the following order:

(i) Any amount deemed distributed for such year under § 1.995-3 (relating to